Welcome

In view of the continuing economic climate and the harsh realities of maintaining a sustainable business, this March 2009 issue of the Employment Tax for Business newsletter focuses on employment termination payments.

Background
Where all other options have been exhausted, and the final, difficult decision is made to reduce the size of the workforce, it is as important as ever to maximize the cost of any compensation, whilst at the same time complying with Income Tax and National Insurance regulations as an employer. Such issues can be extremely complicated. Businesses will not wish to fall foul of their compliance obligations, yet must ensure excessive duties are not paid. The following topics are key areas and whilst not all present significant difficulties, at the top of the list is the one creating the most problems and risks, Payments In Lieu Of Notice.

Payments In Lieu Of Notice (PILONs)
The tax issues on PILONs can briefly be summarised as follows:

(a) When an employee's contract (including any applicable employer policies or staff agreements) provides a clause giving the employer discretion to make PILON, and this clause is invoked, then it is quite likely the payment will attract tax and NIC in full.
(b) There may be many cases where PILON does not attract tax or NIC. Within this category may be instances where the contract does have a discretionary PILON clause but there is clear evidence that the contract has been breached, particularly where there is also an element of mitigation. Also there may be many cases where PILON is paid and the contract does not contain a PILON clause. In all these cases, any PILON paid as non-contractual damages should qualify for the £30,000 tax exemption and fall wholly outside the scope of NIC.
(c) For cases within (b) where there is no contractual PILON clause, employers also need to undertake a case by case critical assessment, to avoid any suggestion that such compensation is paid as an 'automatic' process (i.e. avoiding what HMRC refer to as an "Auto PILON").

Statutory Redundancy Payments
Legislation provides for a statutory compensation to be paid where the termination of employment is due to redundancy. The payment is subject to a maximum limit (£350 per week as from 1 February 2009) and is calculated based on the employee's age and length of service. These statutory payments are covered by the £30,000 tax exemption and fall wholly outside the scope of NIC. Non-statutory, or 'enhanced', redundancy payments will normally have the same tax and NIC treatment, provided these are similar in purpose and computation (for example, using actual week's pay in the calculation rather than the statutory maximum). Care is however needed where Redundancy Policies, Security of Employment Agreements, or Collective Agreements negotiated with Unions, create an entitlement or intention to pay specific sums for something other than redundancy (e.g. PILONs). Such policies may create entitlement to separate contractual payments which could be liable to tax and NIC in full.

Compensation for loss of office/termination of employment other than redundancy
Provided the payment is not contractual (e.g. it is not referred to in any service agreement, staff handbook, etc.), and is determined as compensation specifically in connection with the termination, this should fall within the £30,000 tax exemption and be wholly outside the scope of NIC. Certain sums, including payments for accepting 'Restrictive Covenants', and 'Terminal Bonuses', will however attract tax and NIC in full. In some cases, an enhanced severance package linked to a specific leaving date (potentially qualifying for the exemptions), may be a better alternative to paying a taxable 'Terminal Bonus' for extra duties performed before leaving. However great care (and possibly specialist advice) will be needed when drafting relevant documentation and making such payments.

On a general point; if several sums are grouped together as a single 'compensation for loss of office' payment, HMRC will expect that the correct tax treatment is applied to each constituent element.

Ex-gratia Payments
Strictly, ex-gratia payments rarely exist in termination situations as the term means given freely, without any obligation. Where something is described for convenience as ex-gratia, in truth it will probably be something else. Most commonly this 'something else' will be an extra payment to the employee to encourage him/her to accept their severance terms (i.e. its not freely given, but a quid pro quo). This does not necessarily prevent the tax/NIC exemptions applying but extreme care is needed.

Payments into a registered Pension Scheme
A payment by an employer direct into a registered pension scheme can be wholly exempt from tax (i.e. no £30,000 limit) and outside the scope of NIC. Certain criteria apply in relation to the scheme rules and overall limits on funding, but for an employee approaching retirement age this can be a very tax efficient approach to providing an overall termination package which would otherwise exceed the £30,000 tax limit. Care is however needed where any payment is not to a registered pension scheme, as this may then be viewed as an Employer Financed Retirement Benefit Scheme (EFRBS) which can attract both tax and NIC.

Ill Health Termination Payments
Where ill health incapacity brings about the employment termination, then compensation may be paid which again is wholly exempt from tax (i.e. no £30,000 limit) and outside the scope of NIC. Certain criteria apply including the need for there to be a medically certified condition which prevents the employee from working in the specific role, and any payment being made solely on account of this.

And finally… love your taxes…and don't pay too much. There are a number of other areas which can also have tax/NIC efficiencies, which may help to keep down the overall cost of any termination programme, and should be received well by staff. These include **Counselling and Outplacement Services**, **Re-Training Courses**, **Legal Fees**, **Compensation for Benefits**, **Foreign Service** and **Protective Awards**. If you would like further information on these or any other areas, including details of HMRC reporting obligations and other administrative issues, please contact Employment Tax for Business.

About us

Employment Tax for Business is an independent tax consultancy. Based in the North West of England, we provide services to clients throughout the UK. Our business partners have previously led the employment tax departments of major international accountancy practices. Our role is to provide clients with the very highest level of technical expertise, commercial awareness, and personalised service, tailored to individual client needs.

Contacts

If you would like to comment on the contents of this newsletter, or would like to discuss how we can assist with your needs, please contact:

Brian Ackerley: 07712 527355 **Dave Cooper:** 07833 218569

Email: employmenttax@aol.com **Website**: www.et4b.co.uk